GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Fiscal Note 2015 Biennium

Bill #	SB0092	**Title:**	Revise administration of taxes
Primary Sponsor:	Thomas, Fred	**Status:**	As Introduced

- ☐ Significant Local Gov Impact
- ☐ Included in the Executive Budget
- ☑ Needs to be included in HB 2
- ☑ Significant Long-Term Impacts
- ☑ Technical Concerns
- ☐ Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2016 Difference	FY 2017 Difference	FY 2018 Difference	FY 2019 Difference
Expenditures:				
General Fund	$0	$36,925	$0	$0
State Special Revenue	$0	$0	$0	$0
Other	$0	$0	$0	$0
Revenue:				
General Fund	$0	($622,000)	($955,000)	$312,000
State Special Revenue	$0	$0	($10,000)	($59,000)
Other	$0	$0	($3,000)	($19,000)
Net Impact-General Fund Balance:	$0	($658,925)	($955,000)	$312,000

Description of fiscal impact: This bill would revise several provisions relating to interest and penalties for late tax payments, late filing, not filing a return, and filing a false return. Changes to penalties would apply for tax periods beginning after the end of tax year (TY) 2016. Changes to interest would apply beginning in CY 2017.

FISCAL ANALYSIS

Assumptions:

Department of Revenue

Interest Waiver

1. This bill would increase the interest the department may waive from $100 to $500 and allow an additional waiver of $100 per tax period for taxpayers who meet all terms of a payment plan.

2. The department enters into about 5,600 payment plans with taxpayers each year. On average, taxpayers entering into a payment plan have debt from two tax periods. If all taxpayers met all the terms of their payment plans and the department forgave $100 of interest per period to each, the total would be $1,120,000 per year. Not all taxpayers who enter into a payment plan meet all its conditions. About 4% default, and an unknown percent fall behind or otherwise fail to meet all conditions. Also, not all taxpayers with payment plans will have $100 of accumulated interest per period. Therefore, this fiscal note assumes that the department would forgive an additional $560,000 in interest each year.
3. This provision would first apply for payment plans associated with back taxes from TY 2017. These plans would not be set up before FY 2019, and few if any would be paid off before the end of FY 2020. Thus, reduced revenue from increased interest waivers will not occur until FY 2021.

Late Filing Penalty

4. Under current law, the penalty for failing to file a return and pay tax owed by the due date is the lower of $50 or the tax due. This bill would change the penalty to the greater of $50 or 5% of the tax due per month, with a maximum penalty of 25% of the tax due. It also would eliminate penalties for individual income tax returns that are filed by the October extension deadline.
5. Penalties were calculated under current law and under this bill for late-filed income tax returns received during FY 2013. Penalties under this bill were $566,000 higher. Penalties on TY 2012 returns, which were a few months late, were reduced by $12,000. Penalties on TY 2011 returns were increased by $293,000 and penalties on TY 2010 returns were increased by $185,000. Penalties from TY 2009 were increased by $100,000.
6. This fiscal note assumes that this bill would increase late filing penalties by $566,000 for each tax year and that penalty collections for late returns from each tax year will follow the same pattern as for late returns in FY 2013.
7. The changed penalty rates would first be applied in FY 2018 to late returns filed for TY 2017. Penalties on these late returns would be reduced by $12,000. In FY 2019, penalties for late 2018 returns would be reduced by $12,000 and penalties for late 2017 returns would be increased by $293,000. The net effect would be to increase revenue by $281,000. The following table shows the change in penalties through FY 2021, with three tax years being affected in FY 2020 and four tax years being affected in FY 2021.

Estimated Change in Late Filing Penalties under SB 92 as Introduced

FY2016	FY2017	FY2018	FY2019	FY2020	FY2021
$0	$0	($12,000)	$281,000	$466,000	$566,000

Late Payment Penalties

8. 15-1-216, MCA, sets penalties for late payments. Under current law, penalties for taxes where taxpayers pay directly are 1.2% of the amount due per month or fraction of a month with a maximum penalty of 12% of the amount due. Penalties for failure to remit trust taxes collected from employees or customers (withholding, telecommunications, lodging, and rental car taxes) are 1.5% of the amount due per month or fraction of a month with a maximum penalty of 15% of the amount due.
9. This bill would change the penalty rate for directly paid taxes to 0.5% of the amount due per month with a maximum penalty of 12% of the amount due. For all taxes, this bill would make penalties accrue daily instead of being per month or fraction of a month.
10. Penalty and interest payments are recorded separately from other collections in the state accounting system only for individual income tax, corporate income tax, oil and gas tax, coal severance tax, and retail telecommunications tax. For FY 2011 through FY 2014, penalty and interest for individual income tax, corporate income tax, oil and gas tax, and coal severance tax, which are paid directly, were 1.11% of total collections. Penalty and interest for retail telecommunications tax, which is a trust tax, were 0.10% of

total collections for this period. This fiscal note assumes that these percentages will hold in the future for directly paid and trust taxes.

11. Penalty and interest are recorded together in the same accounts, so that the split between penalty and interest is unknown. The sums of penalty and interest calculated at the time of filing for TY 2008 individual income tax and corporate income tax returns were calculated. It was found that penalties were 66% of the total for individual income tax and 43% of the total for corporate income tax. This fiscal note assumes that over all affected taxes, penalty and interest each are half of the total.
12. For taxes paid a few days late, the penalty rates proposed by this bill are a small fraction of current-law rates. This fraction is higher the later a payment is, and once the maximum penalty rate is reached, the penalty is the same as under current law. This occurs after 10 months for trust taxes and after 24 months for directly paid taxes.
13. The HJR 2 revenue estimates were extended through FY 2021 by assuming that the growth rate for FY 2017 would hold for the next four years. For taxes with no revenue estimates, agency budgets were used as the estimates for the consumer counsel tax and public service commission tax, and other taxes were estimated by extending the trend of recent collections.
14. The timing of late payments is unknown. This fiscal note assumes that the proportion of payments a given number of days late decreases exponentially as the number of days late increases, with essentially all late payments received within five years. When fully phased in so that all penalties are imposed at the new rates, average penalties would be approximately 29.6% lower for directly paid taxes and 4.9% lower for trust taxes.
15. This provision would apply to late payments for tax reporting periods beginning after December 31, 2016. The first penalties with the new rates would first be applied in FY 2018. In the first years, a portion of late payments would be for tax periods before December 31, 2016, with penalties assessed at the old rate. Some penalties would continue to be at the old rates for several years, and the change would not be fully in effect until sometime after FY 2020. Penalties for directly paid taxes would be reduced by approximately 1.5% in FY 2018 and 8.6% FY 2019. Penalties for trust taxes would be reduced by approximately 0.7% in FY 2018 and 1.6% in FY 2019.
16. The following table shows projected revenue, estimated penalty payments under current law and under this bill, and the difference, in millions of dollars.

Taxes Paid Directly (Millions $)

	FY2016	**FY2017**	**FY2018**	**FY2019**	**FY2020**	**FY2021**
Forecast Revenue from Affected Taxes	$798.510	$827.826	$859.945	$893.595	$928.857	$965.812
Estimated Late Payment Penalties						
Current Law	$4.433	$4.596	$4.775	$4.961	$5.157	$5.362
Proposed Law	$4.433	$4.596	$4.701	$4.535	$4.369	$4.319
Difference (Proposed - Current)	**$0.000**	**$0.000**	**($0.074)**	**($0.426)**	**($0.788)**	**($1.043)**

Trust Taxes (Millions $)

	FY2016	**FY2017**	**FY2018**	**FY2019**	**FY2020**	**FY2021**
Forecast Revenue from Affected Taxes	$938.449	$991.430	$1,047.537	$1,106.954	$1,169.876	$1,236.507
Estimated Late Payment Penalties						
Current Law	$0.476	$0.503	$0.531	$0.562	$0.594	$0.627
Proposed Law	$0.476	$0.503	$0.528	$0.552	$0.579	$0.607
Difference (Proposed - Current)	**$0.000**	**$0.000**	**($0.004)**	**($0.009)**	**($0.015)**	**($0.020)**

17. Revenue from taxes affected by this bill is split between the general fund and other funds, with 95.6% of trust taxes and 81.8% of directly collected taxes going to the general fund in FY 2014. Assuming that the

same split applies in future years, the following table shows how the revenue impacts are split. Details on impacts by fund are shown in the fiscal impact section.

Estimated Late Payment Penalties by Fund (Millions $) SB 92 as Introduced

	FY 2016	FY 2017	FY 2018	FY 2019
General Fund	$0.000	$0.000	($0.064)	($0.357)
State Special and Other Funds	$0.000	$0.000	($0.014)	($0.078)

Penalties for Substantial Understatement of Tax

18. For the last five years, the IRS imposed accuracy-related penalties, including penalties for substantial understatement of income, on 0.553% of returns.
19. The IRS count of accuracy related penalties includes penalties imposed for reasons other than gross understatement of tax, and some understatements of taxable income that would meet the federal threshold for gross understatement of tax would not meet the threshold in this bill. This fiscal note therefore assumes that the state would impose penalties for substantial understatement at one-fifth the rate of IRS accuracy-related penalties or 0.111% of returns.
20. About 520,000 Montana individual income tax returns and about 16,000 Montana corporate income tax returns will be filed each year. The department will impose about 575 (0.111% x 520,000) penalties on individuals for substantial understatement each year and about 18 (0.111% x 16,000) on C-corporations.
21. This bill defines substantial understatement for individual income tax as the greater of $3,000 or 10% of the correct amount of tax. For all other taxes, it defines substantial understatement as the greater of $10,000 or 10% of the correct amount of tax or any understatement of at least $0.5 million.
22. The minimum penalty for an individual would be $600 (20% x $3,000). The minimum penalty for all other taxes would be $2,000 (20% x $10,000).
23. This fiscal note assumes that the average penalty would be 150% of the minimum, or $900 for individual income tax and $3,000 for other taxes.
24. Annual penalties for substantial understatement of tax would be $571,500 (575 * $900 + 18 * $3,000). Penalties would first be assessed on returns for TY 2017. The first penalties would be assessed and collected in FY 2019.

Penalty for Purposely and Knowingly Failing to File

25. Current law sets the penalty for purposely or knowingly failing to file a return at $1,000 to $10,000. This bill would change that to 15% of the tax due per month with a maximum of 75% of the tax due. It also would make this penalty apply to failure to file an information report, such as for a partnership or S corporation and provide an additional penalty of $1,000 for failure to file a pass-through report or return after being notified that it is required. The exiting provision is intended to serve as a deterrent, and is seldom used. Because penalties are seldom imposed, the proposed change in penalty amount is not expected to affect revenue in a typical year. The department has a backlog of non-filing pass-through entities and shareholders. The department would begin imposing the new additional penalty on those who continue not to file for TY 2017. The department expects to impose this penalty on about 200 non-filers per year. Additional penalties of about $200,000 per year would be collected beginning in FY 2019. If this provision is successful in increasing compliance, penalties would be lower in future years.

Fraud Penalties

26. For the last five years, the IRS reports that the number of tax fraud penalties imposed were 0.0017% of the number of tax returns for individual income tax and 0.0028% of the number of tax returns for corporate income tax. Average federal fraud penalties were about $45,000 for individuals and $173,000 for C-corporations. Since Montana tax rates are about one fifth the corresponding federal rates and apply only

to Montana income, state fraud penalties would be lower. This fiscal note assumes that the average fraud penalty would be one-fifth of the average federal penalty for individuals or $9,000.

27. The department would assess fraud penalties at about the same rate as the IRS. This would result in nine (0.0017% x 520,000 + 0.0028% x 16,000) penalties per year. Annual penalties would be $81,000 (9 x $9,000). The first fraud penalty assessments would be for TY 2017. They would be assessed and collected in FY 2019.
28. Section 4 makes filing a false or fraudulent claim for the elderly home-owner renter credit subject to the same penalty and interest provisions as other taxes. This change is included in the estimate of fraud penalties.

Penalty for Frivolous Returns

29. This bill creates a penalty of $2,500 for filing a frivolous return. The department would occasionally impose this penalty, but not every year. Therefore, no revenue is estimated from this provision.

Interest on Late Income Tax Payments

30. Under current law, interest on late income tax payments is charged at the greater of the rate established by the IRS for the last quarter of the previous year or 8%. This bill would remove the 8% floor at the beginning of 2017 and use the IRS rate for the third quarter of the previous year. This change would apply for interest charged in 2017 and later years.
31. The IRS rate is calculated quarterly by adding 3% to the average of rates for federal notes and bonds maturing within three years and rounding to the nearest full percentage point. Based on IHS's forecast of interest rates on federal notes and bonds, the IRS rate for the third quarter of the previous year is projected to be 5% for 2017 and 7% for 2018 and 2019. Under current law, the interest rate on late income tax payments would be 8% for each of these years.
32. For FY 2010 through FY 2014, penalty and interest were 0.80% of income tax revenue. Assuming that 34% of recorded penalty and interest is interest (see assumption 11), current law late payment interest is assumed to be 0.27% of forecast income tax revenue. The following table shows the HJR 2 forecast of income tax revenue, late payment interest under current law and under this bill, and the difference, in millions of dollars. This bill would first apply to late payments in the last half of FY 2017, so the impact in FY 2017 is only for half a year.

Estimated Late Payment Interest (Million $)

	FY 2016	FY 2017	FY 2018	FY 2019
Forecast Income Tax Revenue	$1,161.33	$1,229.61	$1,301.90	$1,378.44
Current Law	$3.136	$3.320	$3.515	$3.722
Proposed Law	$3.136	$2.697	$2.636	$3.257
Difference (Proposed - Current)	**$0.000**	**($0.622)**	**($0.879)**	**($0.465)**

Provisions with Minimal Impact

33. Section 2(2) specifies that there is to be no late payment penalty if the taxpayer has met requirements for income tax withholding or estimated payments during a tax year or if the taxpayer pays within 30 days of receiving an assessment notice. The Department of Revenue generally waives penalties in these cases, so there would be minimal revenue impact.
34. Section 5(5)(f) specifies that there is to be no underpayment interest if a taxpayer has met requirements for income tax withholding or estimated payments during a tax year by making four approximately equal estimated payments. Since four equal payments is the default requirement for estimated payments, few taxpayers would be affected by this provision.

35. Section 3(15) gives a procedure for determining the portion, if any, of a taxpayer's federal income tax refund that must be included in adjusted gross income. This is the same as the procedure in administrative rules, and there would be no effect on revenue.

Total Revenue Impact

36. The following table shows all of the revenue impacts of this bill. FY 2020 and FY 2021 are shown because some provisions will not affect revenue until after FY 2020.

Summary of Total Revenue Impacts of SB 92 as Introduced (Million $)

General Fund	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021
Interest Waiver	$0.000	$0.000	$0.000	$0.000	$0.000	($0.560)
Late Filing Penalty	$0.000	$0.000	($0.012)	$0.281	$0.466	$0.566
Late Payment Penalties	$0.000	$0.000	($0.064)	($0.357)	($0.659)	($0.873)
Substantial Understatement Penalties	$0.000	$0.000	$0.000	$0.572	$0.572	$0.572
Non-Filer Penalty	$0.000	$0.000	$0.000	$0.200	$0.200	$0.200
Fraud Penalties	$0.000	$0.000	$0.000	$0.081	$0.081	$0.081
Interest on Late Income Tax Payments	$0.000	($0.622)	($0.879)	($0.465)	($0.493)	($0.522)
Total	**$0.000**	**($0.622)**	**($0.955)**	**$0.312**	**$0.167**	**($0.536)**
Other Funds						
Late Payment Penalties	**$0.000**	**$0.000**	**($0.013)**	**($0.078)**	**($0.144)**	**($0.191)**

37. Changes to the penalty and interest calculations in the department's data processing system would be done by the vendor at a cost of $36,925 in FY 2017.

	FY 2016 Difference	FY 2017 Difference	FY 2018 Difference	FY 2019 Difference
Fiscal Impact:				
Department of Revenue (DOR)				
Expenditures:				
Operating Expenses	$0	$36,925	$0	$0
TOTAL Expenditures	$0	$36,925	$0	$0
Funding of Expenditures:				
General Fund (01)	$0	$36,925	$0	$0
TOTAL Funding of Exp.	$0	$36,925	$0	$0
Revenues:				
General Fund (01)	$0	($622,000)	($955,000)	$312,000
State Special Revenues (02)	$0	$0	($10,000)	($59,000)
Other	$0	$0	($3,000)	($19,000)
TOTAL Revenues	$0	($622,000)	($968,000)	$234,000
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	$0	($658,925)	($955,000)	$312,000
State Special Revenue (02)	$0	$0	($10,000)	($59,000)
Other	$0	$0	($3,000)	($19,000)

The detail break out of the revenue change by fund other than the general fun is listed below.

Revenue Detail by Fund	FY 2016	FY 2017	FY 2018	FY 2019
2008 Tobacco And Cig. Tribal Agree.	$0	$0	($393)	($2,273)
2015 TSEP Regional Water System	$0	$0	($516)	($2,985)
2034 Earmarked Alcohol Funds	$0	$0	($161)	($933)
2049 Hard Rock Mining	$0	$0	($29)	($166)
2070 Hazardous Waste-CERCLA	$0	$0	($31)	($177)
2083 Oil & Gas Local Assistance	$0	$0	($286)	($1,655)
2102 Montana Heritage Commission	$0	$0	($2)	($4)
2105 Basic 9-1-1 Emergency Phone Prog	$0	$0	($14)	($33)
2110 Accommodation Tax Admin	$0	$0	($1)	($2)
2111 Accommodation Tax Account	$0	$0	($3)	($6)
2116 Accommodation Tax Account	$0	$0	($70)	($162)
2123 Sites & Signs	$0	$0	($1)	($2)
2135 SW MT VETS HOME	$0	$0	($69)	($397)
2159 Handicapped Telecommunications	$0	$0	($6)	($15)
2162 Environmental Quality Protection	$0	$0	($31)	($177)
2169 Bentonite Production Tax	$0	$0	($51)	($293)
2216 Water Storage St Sp Rev Acct	$0	$0	($12)	($71)
2254 Regional Accommodation Tax	$0	$0	($24)	($56)
2260 Cigarette Tax Revenue	$0	$0	($475)	($2,749)
2270 Treasure State Endowment	$0	$0	($779)	($4,511)
2274 FWP Accommodations Tax	$0	$0	($7)	($16)
2281 Public Service Commission	$0	$0	($403)	($2,332)
2289 Bureau Of Mines Groundwater	$0	$0	($51)	($297)
2293 Film Production Credit	$0	$0	$0	($1)
2340 Coal Sev. Tax Shared SSR	$0	$0	($258)	($1,495)
2397 Enhanced 9-1-1 Emerg Tel Pgm	$0	$0	($14)	($33)
2443 University Millage	$0	$0	($1)	($5)
2445 Coal Board	$0	$0	($175)	($1,011)
2576 Natural Resources Operations	$0	$0	($80)	($463)
2577 Natural Resources Projects	$0	$0	($309)	($1,789)
2579 Coal & Uranium Mine Account	$0	$0	($21)	($119)
2594 Statewide 911 Services Admin	$0	$0	($2)	($4)
2698 69010-Prevention&Stabilization	$0	$0	($14)	($82)
2771 Big Sky Economic Dev Program	$0	$0	($213)	($1,234)
2772 Tobacco Hlth and Medicaid Init	$0	$0	($3,005)	($17,388)
2801 Dep Rev Consumer Cncl Tax	$0	$0	($119)	($686)
2853 Accommodation Tax	$0	$0	($3)	($6)
2966 Tribal Agreement - Alcohol	$0	$0	($9)	($52)
2989 69010-Hospital Utilization Fee	$0	$0	($1,820)	($10,531)
2990 69010-Nursing Home Utilization	$0	$0	($744)	($4,305)
2993 911 Wireless	$0	$0	($14)	($33)
2994 911 Wireless Providers	$0	$0	($14)	($33)
4011 GO Bond Debt Ser-Renew Resource	$0	$0	($45)	($260)
4070 CERCLA GO Debt Service	$0	$0	($22)	($129)
4162 Hard Rock Debt Service	$0	$0	($97)	($563)
5007 Long Range Building Program	$0	$0	($717)	($4,147)
9004 Coal Tax-FWP Trust	$0	$0	($60)	($348)
9037 Cultural Trust	$0	$0	($30)	($173)
9042 Coal Severance Tax Bond Fund	$0	$0	($2,366)	($13,692)

Effect on County or Other Local Revenues or Expenditures:

1. Some of the state special revenue funds that will have small decreases in revenue are distributed to local governments

Long-Term Impacts:

1. Fraud penalties beginning in FY 2019 would increase revenue by $81,000 per year while the increased interest waivers beginning in FY 2021 would reduce revenue by $560,000 per year.
2. The revenue impact of the change to late payment interest will vary from year to year. In years when the IRS rate is 8% or higher, there will be no revenue impact. In years when the IRS rate is lower than 8%, there will be a revenue reduction, with lower IRS rates leading to larger revenue reductions. Since 1999, the IRS rate has been 8% or higher about one-fourth of the time.

Technical Notes:

1. The bill does not specify how the waiver of interest for completing a payment plan would be implemented.

			1/8/15
Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*